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IN THE
Supreme Court of the United States
OCTOBER TERM, 1947

No. 146

ARTHUR D. SCHULTE, JOHN S. SCHULTE and DAVID A.
SCHULTE, JR., as Trustees under a trust agreement
dated June 3, 1932, made by David A. Schulte, as
Grantor,

Petitioners,

against

PARK & TILFORD, INC.,

Respondent,

UNITED STATES OF AMERICA,

Intervenor-Respondent,

MARJORIE D. KOGAN, on her own behalf and on behalf
of all other stockholders of Park & Tilford, Inc.,
similarly situated, and in the right of Park & Til-
ford, Inc.,

Intervenor-Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES
CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

**BRIEF FOR INTERVENOR-RESPONDENT
MARJORIE D. KOGAN, IN OPPOSITION**

NATHAN B. KOGAN,
Attorney for Intervenor-Respondent,
Marjorie D. Kogan.

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**BRIEF FOR INTERVENOR-RESPONDENT
MARJORIE D. KOGAN, IN OPPOSITION**

This brief is submitted on behalf of intervenor-respondent, Marjorie D. Kogan, a minority stockholder of Park & Tilford, Inc., who by order of the circuit court of appeals was permitted to intervene as a party to the action on behalf of minority stockholders and in the right of Park & Tilford, Inc., because the "interests of minority stockholders were not adequately represented by existing parties to the action" (R. 121).

The record recites circumstances showing the identity of interests of the respondent, Park & Tilford, Inc., its counsel, the petitioners and their counsel and the control of respondent, its officers and directors by petitioners by reason of their ownership of more than a majority of Park & Tilford's voting common stock (R. 97-101).

**Opinions Below
Jurisdiction
Questions Presented
Statute Involved**

To avoid burdensome repetition, this brief will not include any of the matters covered by the brief to be submitted on behalf of the United States and the Securities & Exchange Commission, in opposition to the petition for a writ of certiorari, and reference is made to that brief for the statements concerning the Opinions Below, Jurisdiction, Questions Presented and Statute Involved*

POINT I

The facts conclusively demonstrate that the petitioners as insiders, abused their fiduciary position, acquired common stock, sold the same to an uninformed public, and profited in violation of the statute.

The brief submitted by the United States and the Securities & Exchange Commission demonstrates that the acquisition by conversion is a "purchase" within the express language of the statute.

However, beyond the narrow confines of the conversion itself, is the factual background for the conversion. The

*Intervenor Kogan has read the page proof of the brief to be submitted on behalf of the United States and the Securities & Exchange Commission and concurs fully in all of the arguments presented therein.

factual background reveals fully the violation not only of the letter of Section 16(b) of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U. S. C. 78 p. (b)), but also of the spirit and purpose of said statute.

Park & Tilford, Inc. is a Delaware corporation, whose common stock is registered on the New York Stock Exchange (R. 31).

David A. Schulte was and is the dominant figure in the affairs of Park & Tilford, Inc. (R. 23, 117, 121). Until April 9th, 1945, David A. Schulte was president and a member of Park & Tilford, Inc.'s. five man board of directors (R. 97, 117).

On June 3rd, 1932, David A. Schulte created a family trust under which his three sons, the petitioners Arthur D. Schulte, John S. Schulte and David A. Schulte were appointed trustees. Mr. Schulte vested the petitioners with majority control of the corporation, by an ownership of 66% of the voting common stock (R. 76, 97, 117).

"On November 30, 1943, there were 243,731 shares of Park & Tilford common stock outstanding. Of this amount, the public held 18,249 shares or 9%; Schulte owned 54,510 shares or 22% directly; the 1924 Corporation, controlled by Schulte, held 4,853 shares or 2%, and 165,119 shares or 67% were held by the David A. Schulte Trust (the petitioners) which Schulte created for his family and friends and whose trustees were his three sons. It is conceded that the Schulte interests, holding over 90% of the common stock, controlled Park & Tilford, Inc." In addition, the Schulte interests owned 99% of all the outstanding preferred stock, which was not listed on any exchange. At that time out of 6,929 shares of outstanding preferred stock, the petitioners held 6,604 shares and David A. Schulte held 274 shares. (*Matter of Ira Haupt & Co.*, Securities Exchange Act of 1934, SEC Release No. 3845, p. 4, Aug. 20th, 1946) (R. 145).

The petitioners elected and controlled the officers and directors of the corporation. The board of directors was elected by a single ballot cast by the petitioners, who voted their majority stock (R. 98).

In 1945, David A. Schulte became chairman of Park & Tilford's five man board of directors (R. 97).

Petitioner, Arthur D. Schulte is president of Park & Tilford and a member of its board of directors. Jerome A. Eisner, a director of the corporation, is a beneficiary of the Schulte Trust to the extent of \$12,000 per year. He is a member of the law firm who represents the petitioners in this proceeding and who at the same time are and for many years were general counsel for the respondent Park & Tilford, Inc. (R. 98).

Another director, Pheifer, comptroller of Park & Tilford, is in the personal employ of David A. Schulte (R. 98).

The attorneys for the respondent Park & Tilford, Inc. in this action were retained by the five man board of directors at a meeting held on October 27th, 1944, attended and approved by David A. Schulte, Eisner and Pheifer (R. 99).

Among the other beneficiaries of the Schulte Trust are the wife of David A. Schulte, who receives therefrom \$82,000.00 per year and the three sons, the petitioners, who receive at least \$25,000 per year therefrom (R. 99).

On November 29th, 1943, the petitioner-controlled board of directors elected to redeem all the convertible preferred stock of Park & Tilford as of March 20, 1944 (R. 10-11, 34-35, 64).

Beginning in the latter part of 1943, and ending in May 1944, there was a spectacular rise in the common stock as the result of rumors of an impending liquor dividend by the company (R. 23, 118). On December 15th, Schulte

made a public announcement of a contemplated whiskey distribution by Park & Tilford to its shareholders. (*Matter of Ira Haupt & Co.*, Securities & Exchange Act of 1934, SEC Release No. 3845, pp. 4 and 5, Aug. 20th, 1946.)

While the rumors of the whiskey dividend were rife, on January 19th, 1944, the petitioners exercised their option to convert their 6,604 shares of preferred stock, into common stock at the rate of $1\frac{1}{4}$ shares of common stock for each share of preferred. By the conversion, the petitioners acquired 8,255 shares of the common stock (R. 8-9, 34, 79).

On the conversion date, the stipulated market price of the common stock was \$58.25 per share or \$480,853.75 for 8,255 shares, and the stipulated value of the preferred, including the right of conversion was \$364,871.00 (R. 65, 80, 81).

Within six months after the acquisition of the common, the petitioners sold 8,255 shares of common stock along with some 30,000 additional common shares held by them (R. 6, 37, 55, 80). These 8,255 shares sold between \$93 and \$98 per share between May 6th and May 26th, 1944, for a total of \$782,999.59 (R. 55).

When the liquor dividend was announced on or about June 1st, 1944, it turned out not to be in fact a dividend, but an offer to the stockholders to buy Park & Tilford Reserve whiskey, subject to Office of Price Administration limitations of negotiability, and the price of the common stock fell from a high of \$98.25 on May 26, 1944, some \$68 per share to a new low of \$30 per share in June to the detriment of thousands of stockholders who had come in on the rise (R. 23, 48, 145, 146).

Thus, the insiders, David A. Schulte, his 1924 Corporation and the petitioners "unloaded" 93,000 shares of \$1 per share common stock, at a profit of many millions of

dollars between December 15, 1943 to May 31, 1944, including the shares acquired on conversion of preferred, before the true nature of the "dividend" was revealed to the public. The petitioners retained enough of the common stock to maintain their control of Park & Tilford. As of May 31st, 1944, the petitioners' holdings were reduced to 115,344 shares or 53%, and Schulte owned 2,410 shares or 1% (R. 98). During this same period, the public's holdings were increased from 18,249 or 8% to 115,344 or 46% (*Matter of Ira Haupt, supra*).

The intervenor Marjorie D. Kogan purchased 50 shares of Park & Tilford common stock on the New York Stock Exchange on March 10th, 1944. (Petitioners' statement commencing at the foot of p. 3 of the petition to the effect that her stock was acquired on March 10th, 1945, is probably a typographical error). She sold 25 shares on April 28th, 1944. Since March 10th, 1944, she has been an owner of Park & Tilford common stock and since May 3rd, 1944, she has been a stockholder of record (*Kogan v. Schulte*, 61 F. Supp. 604, 5, S.D.N.Y.).

On April 28th, 1944, intervenor Marjorie D. Kogan, notified the corporation that Mr. Schulte in his own name and through others realized profits from purchases and sales of the stock of the corporation in violation of Section 16-b of the Securities & Exchange Act of 1934, and she demanded that action be brought against Mr. Schulte and the others involved with him to recover such profits (R. 99, 102).

On June 19th, 1944, as a result of that demand, David A. Schulte repaid some \$264,827.57 (R. 100).

On September 12th, 1944, Kogan commenced action pursuant to Section 16(b) against David A. Schulte, John D. Pheifer, Jerome Eisner, 1924 Corporation and Park & Tilford, Inc. in the United States District Court, Southern District of New York (Civil 27-302). In that action she

alleged that the petitioners Schulte Trustees were a "dummy" of David A. Schulte.

On November 17th, 1944, the instant action was brought by Park & Tilford, Inc. pursuant to Section 16(b) of the Act, to recover profits realized by petitioners on the purchase and sale within six months of the 8,255 shares of common stock acquired by conversion on January 19th, 1944.

David A. Schulte converted his 274 shares of preferred stock on January 31st, 1944, and acquired 342½ shares of common stock, which he sold along with thousands of other shares on the high, within six months thereafter. This transaction was identical with the conversion by the petitioners of their 6,604 shares on January 19th, 1944.

On June 20th, 1945, the district court in the action entitled "Marjorie D. Kogan, suing in her own behalf and on behalf of all other stockholders of Park & Tilford, Inc. similarly situated, plaintiff, against, David A. Schulte, John D. Pheifer, Jerome Eisner, 1924 Corporation and Park & Tilford, Inc., defendants (Civil 27-302)" on a motion for partial summary judgment held, in an opinion reported at 61 F. Supp. 604, (1) that Mr. Schulte's acquisition of common stock upon conversion of preferred was a "purchase" within the meaning of Section 16(b); (2) that the acquisition did not come within the exception provided in Section 16(b) for securities acquired in good faith in connection with an antecedent debt; and (3) that Section 16(b) as applied to the transactions, was constitutional, citing *Smolowe v. Delendo*, 136 F. 2d 231, certiorari denied 320 U. S. 751.

On January 31st, 1946, the district court entered judgment herein after a trial, based on stipulations of counsel for the corporation and the petitioners, in the sum of \$302,145.81, with interest from May 26th, 1944 (R. 83-84). The court in its memorandum opinion held that the peti-

tioners' acquisition by conversion was a "purchase" (R. 87); that the acquisition was not within the exception provided for good faith acquisitions in connection with an antecedent debt (R. 90); and that Section 16(b) as applied to such acquisition was constitutional (R. 90).

On appeal (in opinions reported at 160 F. 2d 984 and 989 (R. 116-121, 142-147)), the circuit court of appeals affirmed the district court on the questions of statutory construction and constitutional validity of Section 16(b) which are here involved. The circuit court of appeals cited "as a reasoned opinion" *Kogan v. Schulte*, 61 F. Supp. 604, where identical questions were similarly decided (R. 118).

The circuit court of appeals disagreed with the district court only as to the amount of the recoverable profits, and held that the judgment should be increased to \$418,128.59, because the district court had erroneously used the market price of the common stock as the "purchase price" of the common acquired on conversion, instead of the lower value of the preferred as stipulated by the parties and found by the trial judge (R. 120). The increase of damages was asked for by intervenor Kogan, who had been permitted to intervene on the appeal because of the "control" situation and the clear "inadequacy of representation" (R. 121).

Petitioners applied for a rehearing before the circuit court of appeals only with respect to the increase of the judgment and strangely enough, they were joined by the plaintiff-respondent Park & Tilford (R. 142-143)! Rehearing was denied, one judge dissenting, suggesting a new trial only with respect to the increased amount of the recovery (R. 142-147). The majority held that to do this, would require repudiation of the "rational and deliberate" stipulations of counsel as to value, and upon the facts denied the petition for rehearing.

Thus, we have nothing in this case but a purchase and sale of Park & Tilford common stock. The petitioners wanted to profit from an expected temporary rise in the market price of Park & Tilford. They knew the rise in the price was temporary because it was based on a false rumor. The question was how could they profit the most. They owned 6,604 shares of Park & Tilford preferred. As controlling stockholders, they could not publicly sell this block of Park & Tilford preferred because they would be obligated to register the offering and thereby be forced to disclose the truth. They could not sell the Park & Tilford preferred in small lots because it was not listed on any securities exchange and there was no ready market for the preferred (R. 145). They could not exchange and sell the Park & Tilford common in a block because that would again require registration and disclosure. To profit, they could only convert the preferred stock, thereby acquire the common stock, and gradually unload the common stock on the public at higher prices inflated by the false rumors.

Clearly if this is not a purchase and sale, then the statute is for naught. The petitioners used their inside position and knowledge to make a "short swing" profit. If such a transaction is exempted the way will be clear for insiders to profit. Thus a director need only own convertible preferred stock to profit from his inside information. On the eve of a favorable development of which the director has inside knowledge, the director can convert this preferred stock, acquire the speculative common stock, sell the common stock within six months thereafter, and realize a profit at the expense of the uninformed public. A convertible security will become a license to escape 16(b). Especially so, as in the instant case, where the convertible security had no public distribution, and was practically all owned by the insiders who had exclusive knowledge of the benefits to be realized by conversion.

The judgment below does not include all of the Schulte profits. Many millions of dollars of Schulte profits in Park & Tilford stock are beyond the scope of the statute. The \$264,827.57 repaid to the corporation by David A. Schulte and the \$418,128.59 judgment below against the Schulte Trustees aggregates \$682,956.16. This is but a small fraction of the millions of dollars realized by the Schulte interests in Park & Tilford stock and is only about 10% of the decline of \$68 a share on the 93,000 shares which the Schulte interests unloaded on the public. In the one month from May 1944 to June 1944 the market price of the additional 93,000 shares declined (in an otherwise rising market) from \$98 per share to \$30 per share, or a loss of \$6,324,000 in the market value of said stock. It is not without significance that Mr. David A. Schulte has recently been in the process of reacquiring the stock and as of May 1947 again owned 10,810 shares of Park & Tilford common.

The court below has not decided federal questions in conflict with applicable law. On the contrary, the decision below is correct and in accord with existing decisions involving the same questions.*

There is no conflict of decisions either in the circuit court of appeals or with applicable decisions of the Supreme Court, involved in this case.

On the contrary there is complete unanimity both in the district court and the circuit court of appeals as to the true intent and meaning of the statute. Two district court judges in two separate cases, and three circuit court of appeals judges in well-reasoned opinions, have unani-

* *Smolowe v. Delendo Corp.*, 2 Cir. 136 F. 2d 231, 148 A.L.R. 300, certiorari denied, 320 U. S. 751. *Kogan v. Schulte*, 61 F. Supp. 604 D. C. S. D. N. Y. *Madden v. Commissioner of Corporations and Taxations*, 280 Mass. 321, 323, 182 N. E. 480 (1932), where an acquisition of stock through the surrender of rights was held to be a purchase.

mously construed Section 16(b) of the Securities Exchange Act of 1934 to include as a "purchase" an acquisition of common by conversion of preferred stock; have held that no "debt" is involved, and have upheld the constitutionality of the statute.

There is no confusion as to leave doubt as to the true intent, meaning and constitutionality of the statute, as applied to the facts at bar. There are no other cases involving similar questions pending in the lower federal courts.

CONCLUSION

The petition for a writ of certiorari should be denied.

July 31, 1947.

Respectfully submitted,

NATHAN B. KOGAN,
Attorney for Intervenor-Respondent,
Marjorie D. Kogan.